



## China Perspectives

2017/2 | 2017  
Processual Change in Taiwan

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Cheltenham (UK), Northampton (MA, USA), Edward Elgar Publishing, 2016, 234+xii pages.

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#### Electronic version

URL: <http://journals.openedition.org/chinaperspectives/7367>

DOI: 10.4000/chinaperspectives.7367

ISSN: 1996-4617

#### Publisher

Centre d'étude français sur la Chine contemporaine

#### Printed version

Date of publication: 1 June 2017

Number of pages: 78-79

ISSN: 2070-3449

#### Electronic reference

Sandra Poncet, « Cai Fang, *China's Economic Growth Prospects: From Demographic Dividend To Reform Dividend*, », *China Perspectives* [Online], 2017/2 | 2017, Online since 01 June 2017, connection on 23 September 2020. URL : <http://journals.openedition.org/chinaperspectives/7367> ; DOI : <https://doi.org/10.4000/chinaperspectives.7367>

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# Cai Fang, *China's Economic Growth Prospects: From Demographic Dividend To Reform Dividend*,

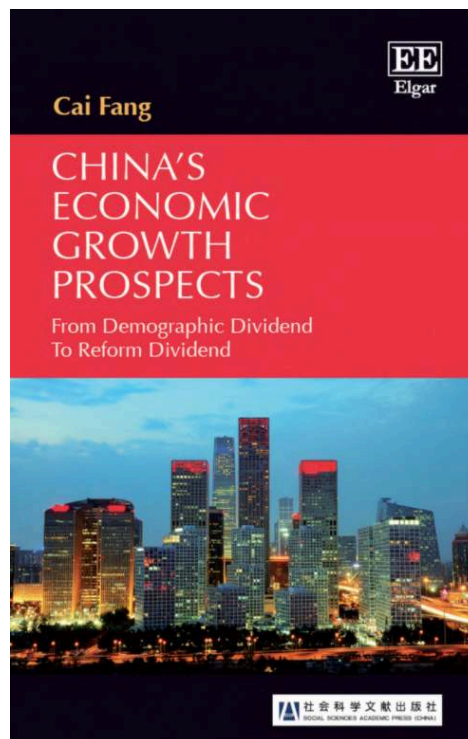
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- 1 Cai Fang is a demographer and economist, currently director of the Institute of Population and Labour Economics, Chinese Academy of Social Sciences (CASS). He is a member of the Standing Committee of the National People's Congress (since 2008) and author of many books and research articles on China's demographic transition and the reality of its growth process.

- 2 His book, *China's Economic Growth Prospects: From Demographic Dividend to Reform Dividend*, combines theoretical reflections and empirical work to analyse the engines of China's growth and to explain the deceleration underway. The argumentation highlights the existence of a demographic dividend, the source of a sea of workers behind China's industrialisation and development process until recently. The book's main aim is to signal the end of this demographic dividend, portending the evaporation of China's comparative advantage based on low-cost work and the inevitable slowing of



the growth rate. The various chapters discuss the main challenges China has to face so as to avoid getting stuck in the so-called middle income trap and to eventually join the league of rich nations.

- 3 The reflection covers different themes at the heart of the author's expertise, such as ageing population, labour's contribution to growth, migratory flows, income inequality, and quality of education, for which theoretical argumentation and corrected official figures are mobilised. The rich and at times technical discussion envisages unavoidable adjustments and perilous conditions. The rest of the book analyses rebalancing of growth, from a model drawing on an accumulation of factors (labour and public investment) and export of low-quality manufactured goods, towards a process based on innovation and domestic consumer demand, especially for services. The chapters on recommendations and policies and on pitfalls to avoid are particularly interesting, especially given the author's proximity to the authorities. The discussion implicitly deals with the difficulty of abandoning China's traditional policy of macro-economic support such as its industrial policies, regional strategies, and stimulus packages in favour of those that would actually boost modernisation of the industrial structure and innovation.
- 4 The book is divided into 12 thematic chapters. At about 15 to 20 pages each, they offer a persuasive analysis of the sources of growth deceleration, the risks to be overcome if China is to become a developed economy, and different proposals for economic policies to get there. The analysis often refers to the experience of China's neighbours, such as South Korea and Japan.
- 5 The first six chapters discuss the relevance for China of the dual sector development theoretical framework and demonstrate Chinese specificity when it comes to demography's contribution to economic growth. Chapter 1 sets the scene, describing the advantage of lagging behind economically while in a trajectory of catching up: borrowing, purchasing, and imitating technologies that already exist overseas makes for rapid growth, which however inexorably slows as the technological gap begins closing. China is nearing this crossroads. Chapter 2 turns to the theory of dual economy development characterised by a surplus of farm labour. In this model, workers' migration towards urban industry naturally fuels the industrialisation process and productivity gains. This engine, which worked full steam in boosting China's growth, is now nearly extinguished. Chapter 3 relies on recent detailed data to show that in the middle of the last decade, China reached what is called "the Lewis Turning Point," after which the extinction of surplus labour led to wage increases and contributed to growth deceleration. Chapter 4 describes the end of the demographic dividend linked to the reduction in the proportion of the working-age population, while Chapter 5 discusses the inexorably aging population. Chapter 6 examines the possibility of such evolutions, pegging China in the category of middle-income countries that are unable to join the ranks of rich nations.
- 6 The last six chapters discuss the measures to be adopted if China is to avoid this scenario. Chapter 7 relies on the neoclassical theoretical framework of growth to identify scientific and technological innovation as the only way of escaping this trap. The chapter presents Schumpeter's "creative destruction" mechanism as a prerequisite for gains in efficiency and innovation. The author delivers a no-holds-barred criticism of economic interventionism by the Chinese authorities. He holds up the policies of macro-economic stimulus, support for state enterprises, massive investment in

strategic sectors, and the Go-West Development Strategy as bearers of nefarious distortions blocking innovation. Chapter 8 continues with a critical analysis of traditionally pursued macro-economic policies in China, interestingly rejecting the idea of an inevitable arbitrage between reform and growth. It is this vision that led Chinese authorities to keep backing inefficient sectors and backsliding on reform, thus leading to further weakening. The author blames this for merely aggravating the problem, holding that only reforms (not clearly specified) removing institutional obstacles can usher in long-term sustainable growth. Chapter 9 is at the heart of recommendations and policies for avoiding the two risks the author identifies: lack of human capital indispensable for a growth process based on innovation, and major structural unemployment that can cause social unrest. The author warns of the possibility that China, like Japan earlier, will have to deal with the recent difficulties faced by higher education graduates in the job market thanks to reduced investment in education. He holds that the reduction in resources for higher education is behind Japan's economic deceleration, clearly appealing to the Chinese government to augment public expenditure for primary and secondary education to boost the quality of teaching. These public expenditures will also cut costs for families, hence boosting demand for their children's education and consumption in general. Chapter 10 focuses on the evolution of inequality in China, presenting data corrected for some imperfections in the official versions. He points out the need for fiscal reforms to boost redistributive capacity, and calls on leaders to show political courage in fighting the vested interests that naturally oppose such change. Chapter 11 advocates strengthening social protections and labour market institutions as well as reform of migrants' rights. The author bluntly argues for an increase in the ratio of resources handed over to local governments, which cover a major share of social protection expenditure. The last and 12th chapter reprises the various reforms suggested in previous chapters (ending the one-child policy – effective since early 2016 – improving education and training, macro-economic policy reforms, and fiscal reforms) and the details of their beneficial effects. He emphasises that these should be carried out by the centre and not localities so as to ensure a legitimate and uniform process throughout the country.

- 7 While containing some relatively technical passages, the book clearly explains the transition at work in China of a growth dynamic described by the dual-sector development model based on the works of W. Arthur Lewis towards a corresponding dynamic in the neoclassical growth framework. The author holds that the transfer of surplus labour in rural areas towards urban manufacturing, and the ability to bridge the technological gap through absorption of technologies existing elsewhere in the world largely explains China's rapid growth since 1980. The exhaustion of these advantages that stemmed from initial underdevelopment inevitably mitigates the efficiency of a growth strategy uniquely based on capital accumulation due to the "Law of Diminishing Returns." The chapters describing demographic aspects – the author's field of expertise – offer tables and graphics of great utility. In fact, the author marshals some of the most reliable and recent statistics extant in analysing demographic dimensions such as the "Lewis Turning Point," the two demographic dividends, and population projections.
- 8 Paradoxically, the book's highlights lie not in these early chapters that review the universally-known evolutions of China's economy, even though they most convincingly illustrate the need for a change in model. The most interesting developments are those tackling concrete risks related to poor policy management of the transition underway.

The author highlights the need to overcome institutional shackles that prevent the state from jettisoning direct engagement in economic activities. It is a huge challenge: promotion of market competition and reduction of distortions are inevitable for sustaining innovation and up-scaling, the only ways to counter-balance the inexorably rising costs of Chinese labour. While the book expresses the author's well-founded worries over Chinese authorities' capacity to adopt reforms that will inevitably upset special interests and the effects of which would not be immediately felt, it nevertheless carries hope. The final chapters offer various reforms that could help China avoid the "comparative advantages vacuum" after the disappearance of its advantages in intensive sectors using cheap labour.

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## AUTHOR

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